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IN THE

Supreme Court of the United States

OCTOBER TERM, 1961

No. 679

BARROW MANUFACTURING COMPANY, INC.

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in the above-entitled cause on August 24, 1961.

OPINIONS BELOW

The Findings of Fact and Conclusions of Law of the Tax Court are not reported, but are unofficially reported by Commerce Clearing House at 19 T.C.M. 195; being Tax Court Memo. Decision 1960-38 rendered March 15, 1960, and are also set forth in the Record at pages 103 to 132, inclusive. The Opinion of the Court of Appeals is reported at ..... F.2d ....., 61-2 U.S.T.C. ¶9637. (Appendix A, *infra*, page 16).

JURISDICTION

The judgment of the Court of Appeals was entered on August 24, 1961 (Appendix B, *infra*, page 23). On November 24, 1961, the time for filing a petition for writ of certiorari was extended by order of Mr. Justice Black to and including January 21, 1962 (Appendix C, *infra*, page 24). The jurisdiction of this Court is invoked under Section 28 U.S.C., Section 1254.

QUESTION PRESENTED

This case involves a question revolving around conflicting and different interpretations of Section 534 of the Internal Revenue Code of 1954, as amended. The principal issue in this case before the Tax Court involved the taxpayer's liability for the imposition of accumulated earnings tax under Section 531 of the Internal Revenue Code of 1954, which involved principally a factual issue as to whether or not the company had permitted its earnings to accumulate beyond the reasonable needs of its business for the purpose of preventing the imposition of tax on its shareholders for its fiscal years ended June 30, 1951, to June 30, 1953, inclusive. Specifically, the

question sought to be raised by the petitioner in this proceeding involves the proper interpretation of Section 534 of the Internal Revenue Code of 1954, as amended. Prior to the enactment of Section 534 of the Internal Revenue Code of 1954, a determination by the Commissioner that a corporation had allowed its earnings and profits to accumulate beyond the reasonable needs of the business carried with it a presumption of its own correctness, and that any taxpayer against whom the penalty was asserted had the burden of rebutting the presumption. Congress in enacting Section 534 of the 1954 Code in paragraphs (a)(2) to (c) provided that in circumstances wherein the taxpayer elected to file a statement of grounds and facts intending to show the basis thereof, the Commissioner shall have the burden of proving the fact of the asserted unreasonable accumulations in any proceeding before the Tax Court. By Act of August 11, 1955, and c.805, 68 Stat. 689, Section 4, the above provision of the 1954 Code was amended to make it retroactive and applicable in the case of proceedings tried on the merits after enactment of the new statute. The 1955 amendment, therefore, made Section 534 applicable to the instant case, notwithstanding the fact that it involves taxable years which precede the enactment of the 1954 Code.

The petitioner in this case filed a voluminous 23-page statement under Section 534, supported by 16 exhibits, which statement and the exhibits are reproduced at pages 45 to 93 of the Transcript of Record before the Court of Appeals. The Tax Court in sustaining the imposition of the penalty tax against petitioner refused to make a specific finding that the burden of proof was on the Commissioner to prove that the taxpayer had permitted its earnings to accumulate beyond the reasonable needs of its business. The Court instead simply held that based upon the record as a whole the petitioner was

liable for the penalty, so that the burden of proof on the issue was not a significant factor and that, therefore, it was unnecessary to consider the sufficiency of petitioner's statement of grounds and statement of facts in support thereof filed under Section 534(c).

The Court of Appeals for the Fifth Circuit affirmed the decision of the Tax Court and on this issue stated "Under the circumstances, the Tax Court's failure explicitly to impose a burden of proof on the Commissioner does not constitute reversible error."

The question presented by this petition is, therefore, limited to the single point as to whether or not the Tax Court and the Court of Appeals were correct as a matter of law in refusing to consider the voluminous statement filed by the petitioner under Section 534(c) and refusing to hold that the burden of proof was on the Commissioner to prove that the taxpayer had permitted its earnings and profits to accumulate beyond the reasonable needs of its business for the years in question. There is no other point being urged by the petitioner in this proceeding.

STATUTE INVOLVED

The statutory provisions involved are Sections 531 through 537 of the Internal Revenue Code of 1954 which was set forth in Appendix D, *infra*, page 25.

STATEMENT OF THE CASE

This case arose in the Tax Court by the petitioner's filing a petition to said Court following the issuance of the statutory notice of deficiency by the Commissioner for the corporation's

fiscal years ending June 30, 1951, to June 30, 1953, inclusive. The major issue involved the assertion of the unreasonable accumulations penalty prescribed by Section 102 of the 1939 Code for said fiscal years as follows:

Fiscal Year Ended	*Section 102 Penalty*
June 30, 1951	$17,119.44
June 30, 1952	12,333.20
June 30, 1953	19,276.06

The petitioner, Barrow Manufacturing Company, Inc., is a Georgia corporation with principal office at Winder, Georgia, and was chartered on July 10, 1931. Petitioner files its Federal income tax returns on the basis of a fiscal year ending on June 30 of each year. The Company is engaged in the garment manufacturing business, primarily producing sports wear, work clothes, pants and shirts for the wholesale trade. Its business is subject to seasonable fluctuations inherent in the garment manufacturing business.

The business was founded by W. H. Jennings, Sr., who was its President and General Manager from its inception until he resigned on February 15, 1949, one month prior to his death on March 13, 1949. W. H. Jennings, Jr. was elected President on February 15, 1949, and continued to hold that office during the years involved.

Petitioner's outstanding capital stock during the fiscal years in question was owned by members of the Jennings family with one exception, as follows:

Stockholders	*Relationship*	*No. of Shares*
W. H. Jennings, Jr.	Son	4
Mrs. W. H. Jennings, Sr.	Wife	61
Mrs. S. F. Maughon	Sister	15
S. F. Maughon	Brother-in-law	15
Mrs. D. G. Thompson	Daughter	4
Norman T. Camp	None	1

During the fiscal years in question, petitioner's profits after taxes, dividends paid and retained earnings were as follows:

F/Y Ended	*Profits after Taxes*	*Dividends*	*Ret. Earnings*
6-30-51	$70,837.33	$7,000.00	$63,837.33
6-30-52	39,066.98	2,500.00	36,566.98
6-30-53	72,536.02	4,000.00	68,536.02

The earned surplus as of the end of the respective fiscal years involved was $610,789.02, $647,356.00, and $726,718.01.

The Commissioner of Internal Revenue in causing Petitioner's returns for the fiscal years in question to be audited, determined among other things that Petitioner was liable for the penalty prescribed under Section 102 of the Internal Revenue Code of 1939 on the grounds that the company was availed of for the purposes of preventing imposition of surtax upon its shareholders through the medium of permitting its earnings

to accumulate beyond the reasonable needs of the business instead of being distributed. There were several other very minor adjustments to Petitioner's taxable income, none of which are involved in this proceeding.

The Commissioner on May 14, 1956, advised the petitioner in accordance with Section 534 of the 1954 Code of a proposed deficiency for the unreasonable accumulations penalty imposed by Section 102 of the 1939 Code. This notice is contained at pages 26 and 27 of the Record before the Court of Appeals. The notice advised the petitioner that within 30 days from the mailing of the notification, it could submit a statement of grounds, together with facts sufficient to show the basis thereof on which it relied to establish that its earnings and profits had not been permitted to accumulate beyond the reasonable needs of the business. The petitioner took advantage of its rights under Section 534 and filed a lengthy statement together with some 16 exhibits on which it relied to show that it had not unreasonably accumulated its earnings during the years in question. A true copy of the statement filed by the petitioner under Section 534 was attached as an exhibit to petitioner's amended petition before the Tax Court and is printed in its entirety at pages 45 through 93 of the Transcript of Record before the Court of Appeals. The case was heard on April 6, 1959, before the Honorable Morton T. Fisher, and the Tax Court entered its memorandum findings of fact and opinion on March 15, 1960, sustaining the Commissioner's determination in its entirety, and a final decision pursuant thereto was entered on May 17, 1960. The Tax Court in answer to the petitioner's contention that the burden of proof was upon the Commissioner, since it had filed the required statement prescribed by Section 534 of the 1954 Code, and that the Commissioner had not introduced any evidence sufficient to prove that it had accumulated its earnings beyond

the reasonable needs of its business, stated that it had "assumed, *arguendo*, that the burden of proof lay with the respondent", without any specific finding that the burden of proof was in fact upon the Commissioner. The Court then stated that it was "therefore unnecessary to consider the sufficiency of petitioner's statement of grounds and statement of facts in support thereof filed under Section 534."

The Court of Appeals sustained the Tax Court in its entirety and specifically with respect to the burden of proof issue.

This petition for a writ of certiorari is directed to the question of law involving the proper interpretation of Section 534 of the 1954 Code as it relates to the burden of proof in a case of this type before the Tax Court.

REASONS FOR GRANTING OF WRIT

1. The decision of the Court of Appeals for the Fifth Circuit in this connection is submitted to be in direct conflict with the recent decision of the Second Circuit in *R. Gsell & Co., Inc. v. Commissioner*, ...F.2d,..... 61-2 USTC ¶9671 decided on September 22, 1961, reversing 34 T.C. 41, as it relates to the question of burden of proof under Section 534 in an unreasonable accumulations earnings penalty case. We also submit that the present case is in direct conflict on this point with the decision of the Second Circuit in *Casey v. Commissioner*, 267 F. 2d 26, decided in 1959, and a decision of the First Circuit in *Young Motor Co. v. Commissioner*, 281 F. 2d 488, decided in 1960.

In the *Gsell* case, the taxpayer being confronted with the assertion of the Section 102 penalty tax for the years 1947, 1950 and 1952, submitted a statement prior to the issuance of the

statutory notice of deficiency in an effort to take advantage of Section 534 and thereby shift the burden of proof to the Commissioner on the unreasonable accumulations issue. The statement submitted as shown by the findings of fact of the Tax Court was 24 pages in length.

The Tax Court as stated in the opinion of the Court of Appeals for the Second Circuit refused to determine whether the statement was adequate to shift the burden of proof to the Commissioner, and instead the Tax Court found on the whole record that the accumulations were unreasonable in the light of the needs of the business. The language appearing in the Tax Court's opinion is substantially the same as appeared in the opinion of the Tax Court in the instant case. The Tax Court in the *Gsell* case stated "Throughout our discussion, we have assumed petitioner had shifted the burden of proof to respondent, insofar as its reasonable business needs were concerned by virtue of the statement of grounds and facts which it filed pursuant to the provisions of Section 534 of the 1954 Code. We have reached our conclusions as to its reasonable needs on the basis of affirmative facts of record. Thus, we need not consider the sufficiency of petitioner's Section 534 Statement."

Virtually the same language appears in the instant case in the opinion of the Tax Court, wherein it was stated "We have assumed, *arguendo*, throughout our discussion that the burden of proof lay with respondent. Our conclusions, however, are based upon and asserted by the affirmative facts in the record, so that the burden of proof on the issue is not a significant factor. It is unnecessary, therefore, for us to consider the sufficiency of petitioner's statement of grounds and statement of facts in support thereof."

The Court of Appeals in this case in referring to the contention of the petitioner that the Tax Court had not, in effect, placed the burden of proof on the Commissioner in accordance with Section 534, stated "Under the circumstances, the Tax Court's failure explicitly to impose the burden of proof on the Commissioner does not constitute reversible error."

We submit, therefore, that the *Gsell* case and the instant case are in direct and irreconcilable conflict with respect to the issue wherein the Court of Appeals in this case had condoned the Tax Court's failure to make a specific finding that the burden of proof was on the Commissioner and the Tax Court's failure to determine whether the statement filed was adequate to shift the burden to the Commissioner.

As pointed out by the Court of Appeals for the Second Circuit in the *Gsell* case, Congress in enacting Section 534 of the 1954 Code ended the taxpayer's burden of proving that its accumulations were not beyond the reasonable needs of the business by providing a specific statutory method through which taxpayer could switch to the Commissioner the burden of proving that the accumulations were unreasonable in proceedings before the Tax Court. The procedure prescribed was where a taxpayer was sent a preliminary notification informing it that a proposed notice of deficiency includes an amount with respect to the accumulations earnings tax, the taxpayer may shift the burden of proof on the issue of whether the accumulations were beyond the reasonable needs of the business by submitting a statement of grounds together with facts sufficient to show the basis thereof on which it relies to establish that the earnings and profits have not been permitted to accumulate beyond the reasonable needs of the business.

As originally enacted, Section 534 did not apply to the

taxable years involved in this case, since they arose with respect to taxable years predating the effective date of the 1954 Code. However, in 1955, Congress saw fit to further amend this section of the law and make Section 534 applicable to pending cases involving the penalty tax, even though they arose with respect to tax years prior to the first year covered by the 1954 Code.

As shown by the record, the taxpayer in this case submitted a comprehensive and voluminous statement of grounds (R. 46-93) together with numerous exhibits, and we submit that the statement was more than adequate to invoke the application of Section 534 and place the burden of proof on the Commissioner on the issue of the reasonableness of the challenged accumulations in light of the petitioner's business needs.

The Tax Court with the approval and sanction of the Court of Appeals for the Fifth Circuit has expressly refused to determine whether the statement was adequate to shift the burden of proof to the Commissioner precisely in the same manner as was done by the Tax Court in the *Gsell* case. The Second Circuit in a well-reasoned opinion held that it was reversible error for the Tax Court not to determine whether the Commissioner has the burden of proof and persuasion in a case of this kind that the accumulation was unreasonable. As further stated in the opinion of the Court of Appeals for the Second Circuit in the *Gsell* case, Congress purposely inserted Section 534 into the 1954 Code, and the Courts have a duty to give the section its intended effect. The Court further points out that the party having the burden of proof in litigation of this kind does not merely have the burden of coming forward with the evidence; it has the burden of persuasion and once fixed that burden does not shift, citing *Commissioner v. Bain Peanut Co.*, 134 F. 2d 853, 857 (5th Cir. 1943).

We submit that Barrow Manufacturing Company, Inc. having submitted its statement for the purpose of taking advantage of Section 534 shifted the burden of proof on the issue of whether the accumulations were beyond the reasonable needs of the business to the Commissioner, and it was encumbered upon the Government to assume the burden of proof and persuasion that the accumulations were unreasonable. This was not done by the Commissioner before the Tax Court. We submit that the Tax Court in both the *Gsell* and the instant case deprived the taxpayer of the benefits of Section 534 and we earnestly believe that the Fifth Circuit in affirming the Tax Court in this case has approved such action and should be reversed.

Any fair and objective reading of the opinion of the Second Circuit in the *Gsell* case and the opinion of the Fifth Circuit in the present case will clearly disclose that the decisions are in direct and irreconcilable conflict on the effect of Section 534 in a case of this kind.

We also submit that the decision of the Court of Appeals is in conflict with the previous decision of the Second Circuit in *Casey v. Commissioner*. The Tax Court in the *Casey* decision simply concluded that the record as a whole showed that the taxpayer permitted its earnings to accumulate beyond the reasonable needs of its business for the taxable year involved and that, therefore, it was unnecessary to determine under Section 534 where the burden of proving business necessity lay.

The Court of Appeals for the Second Circuit discussed at some length the effect of Section 534 and correctly concluded that the burden of proof was upon the Commissioner and reversed the decision of the Tax Court.

We, therefore, believe that it is absolutely imperative for the Tax Court in a case of this kind to make an express and specific finding as to whether or not the preliminary statement submitted by the taxpayer is sufficient under Section 534 to shift the burden of proof and persuasion as to whether the accumulations were unreasonable and that its failure to do so deprives the taxpayer of a substantial and real benefit intended to have been conferred by Congress. To permit the Tax Court to gloss over and ignore the matter of burden of proof under Section 534 and to completely ignore the taxpayer's statement is tantamount to completely nullifying this statute.

The present case is also in inherent conflict with the decision of the First Circuit in *Young Motor Co. v. Commissioner* 281 F. 2d 488. In this case, the Court of Appeals for the First Circuit has, in effect, held that Section 534 places the burden of proof on the Commissioner and that it is erroneous for the Tax Court to proceed upon the theory that the Commissioner's finding against the taxpayer is to be presumed correct and that the burden of proof is upon the taxpayer to overcome it in a case of this kind, where the taxpayer has taken advantage of the rights conferred by Section 534. The Tax Court in *Young Motor Co.* held that the burden of proving absence of the ultimate corporate activity prohibited by Section 102 was upon the taxpayer, notwithstanding the fact that the taxpayer had submitted a statement under Section 534 of the 1954 Code, and the Court went on further to state that even through the evidentiary element of business need had not been rebutted by the Commissioner because of the statement furnished, that factor then merely became neutral. The Court of Appeals for the First Circuit reversed this holding in final judgment for the taxpayer. The case stands squarely upon the proposition that in a situation of this kind, the burden of proof is upon the Government under Section 534 to show that the accumulations

of earnings were unreasonable in any year in which the accumulations penalty tax is asserted.

2. It is submitted that a determination of the question involved in this litigation is clearly in the public interest. There is a great deal of confusion in this area of Federal tax law as to whether Section 534 shifts the burden of proof to the Commissioner in a case of this kind and more specifically whether the Tax Court is at liberty to simply ignore this burden of proof and the statement submitted by the taxpayer. The Court of Appeals for the Second Circuit in the *Gsell* case has held that it is reversible error not to recognize the shifting of the burden of proof and persuasion to the Commissioner in a case of this kind. The Fifth Circuit has seen fit to hold directly to the contrary in the present case and permit and condone the Tax Court's failure explicitly to impose the burden of proof on the Commissioner. Unless this issue is resolved in this case, the issue will be a recurring one with further conflicts between the various Circuits.

3. There is now pending before the Court a petition for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit in the case of *Raymond I. Smith, Inc., petitioner, v. Commissioner of Internal Revenue, Respondent*. October Term, 1961, No. 524, which it is understood involves as one of the legal points raised the identical issue involved in the instant proceeding. The petitioner in this case is hopeful that the Court will see fit to grant not only its petition, but also that sought in the *Smith* case.

CONCLUSION

Based upon the foregoing, it is submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

HILL AND FRAZIER

By _____

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Attorneys for Petitioner

Dated January 20, 1962

APPENDIX A

IN THE

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 18652

BARROW MANUFACTURING COMPANY, INC.,
Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for Review of Decision of the Tax Court of the United States (District of Georgia).

(August 24, 1961)

Before RIVES, JONES and BROWN, Circuit Judges.

RIVES, Circuit Judge: The Commissioner determined that the petitioner was subject to surtax provided by Section 102 of the Internal Revenue Code of 1939 for the taxable years ended June 30, 1951, 1952 and 1953, as follows:

Year Ended 6/30/51	$17,119.44
Year Ended 6/30/52	12,333.20
Year Ended 6/30/53	19,276.06
Totals	$48,728.70

EXHIBIT "A"

The tax Court sustained the Commissioner's determination. In its "Memorandum Findings of Fact and Opinion" comprising 28 pages of the printed record.[1] the Tax Court concluded that the petitioner, in each of the years in question, permitted its earnings to accumulate beyond the reasonable needs of the business, and that petitioner was availed of for the purpose of preventing the imposition of the surtax upon its shareholders.

After a careful examination and study of the record and the pertinent authorities, we find ourselves in agreement with the findings, opinion and holding of the Tax Court. The material evidentiary facts found by the Tax Court are without dispute; indeed, most of them were stipulated. They are fully stated in the findings of the Tax Court and a brief summary here will suffice.

The petitioner is a Georgia corporation chartered in 1931 with a capital stock of $10,000.00. During the fiscal years in question the capital stock was owned by members of the family of the founder, with the exception of one share owned by a nonrelative. The petitioner is engaged in the garment manufacturing business, primarily producing sportswear, work clothing, pants, and shirts for wholesale trade. Financial statements of the petitioner, found in the opinion of the Tax Court, portray steady growth from the charter date through the taxable years in question. Sales have increased from approximately $61,000 in 1932 to $2,100,000 in 1953, with profits after taxes averaging approximately 5% of sales. In only three years during this period did dividends ever average more than 10% of profits after

[1]Unofficially reported in 19 TCM 195.

taxes, and consequently the earned surplus of Barrow increased from $1,924.76 to $726,718.01. It was the business philosophy of W. H. Jennings, Sr., the petitioner's founder and president from its inception until February 15, 1949, one month prior to his death, to finance all growth in the business with retained earnings and to maintain as liquid and independent financial position as possible, a policy maintained by his son who succeeded him as president through the years in question. Consequently, petitioner had no permanent debt structure and paid for purchased material within 10 days to qualify for discounts. The petitioner's receivables were payable in 30 days in accordance with the standard of many years in the industry, and the bad debts claimed as tax deductions during the years in question were extremely low. The ratio of current assets to liabilities as of June 30 in each of the years in question was 10:1 in 1951, 9.1 in 1952, and 5.4:1 in 1953. The business of the petitioner is subject to a large volume turnover, sizable seasonal fluctuations peaking in March and September, and stiff competitive conditions.

Treasury Regulations 118 (1939 Code) Sec. 39.102-1(c) lists among other things which might be considered as circumstantial evidence of the purpose to avoid surtax "the investment by the corporation of undistributed earnings in assets having no reasonable connection with the business." Accordingly, the Commissioner laid emphasis on the investing of $50,000 in United States Savings Bonds from November 1946 through the years in question, and $100,000 in shares of twenty different Federal Savings & Loan Associations from February 1949 through the years in question. The petitioner insists that those investments were intended to accumulate a fund for the construction of a new factory

building. On this point we agree with the Tax Court's opinion:

> "We have no doubt, after examining the directors' minutes, and upon consideration of the testimony of W. H. Jennings, Jr., that petitioner had in mind some such generalized plan. Moreover, petitioner, in 1950, bought the adjoining property for the modest sum of $2,500, intending to use the land as part of the situs of the future plant together with the property it already owned. Nevertheless, the plan was quite general, not only as to the type of plant, but also as to the time of implementation, which was quite indefinite, and not within the reasonably calculable future. At the time of trial (April 1959), no steps toward implementation were begun or decided upon.
>
> "It is our view that such a vague, generalized project, with no definite plan, and no substantial active move toward implementation, can not be taken to create a reasonable need of a business to accumulate 90 per cent or more of its earnings after taxes for at least three years and, as indicated in the record before us, an indefinite period thereafter. See Dixie, Inc., 31, T.C. 415, 429 (1958) (On appeal C.A. 2); I. A. Dress Co., 32 T.C. 93, 102 (1959), affd. . . . F. 2d . . . (C.A. 2, 1956). World Pub. Co. v. United States, 169, F 2d 186 (1948), certiorari denied 335 U. S. 911 (1949), rehearing denied 336 U. S. 915 (1949)."

Clearly, there is substantial evidence to support this con-

clusion. For instance, W. H. Jennings, Jr. stated in the Tax Court his feelings about expansion when he took over in 1949:

> "I determined not to undertake anything of a major nature until I and the other people responsible for the management of this business had more or less proven ourselves, and felt we could afford to risk going out and investing a lot of money in something of a major nature. . . . Among the uncertainties, of course, was the fact, the possibility that I and other of our key personnel might have been called into the service if it (the Korean War) had expanded into a major war, and there was certainly — it looked like it was going to there."

The minutes of the petitioner's Board of Director's Meeting for June 30, 1951 state: "Engineering our factory and putting up new buildings are both out of the question temporarily unless they are absolutely necessary and I do not consider them so, at least, until we can get more for our money." With the existence of such evidence in the record, we find ourselves unable to conclude that the findings of the Tax Court on this point are clearly erroneous. See 26 U.S.C.A. (IRC 1954) Sec. 7482 (a); Rule 52 (a), Federal Rules of Civil Procedure.

Relying on the decisions in *J. L. Goodman Furniture Co. v. Commissioner*, 11 T.C. 530, and *F. E. Watkins Motor Co. v. Commissioner*, 31 T.C. 31, the petitioner insists "that it is entitled to a sufficient amount of cash to cover one year's operating expenses and the total of its accounts receivable and inventories before being subjected to a Section 102

penalty." In *Smoot Sand & Gravel Corporation v. C.I.R.*, 4 Cir., 1959, 274F. 2d 495, 499, it was found "that the nature of the operations was such as to require a working capital reserve 'for very much less than a full year'." We agree with the Second Circuit's treatment of a like contention in *Dixie, Inc. v. C.I.R.*, 1960, 277 F. 2d 526, 528:

> "The rule of thumb so stated may be one proper for administrative convenience but should rise to no higher level. The search must always be concerned with the need of the particular business as they existed during the particular year. KOMA, Inc. v. Commissioner, 10, Cir., 189 F. 2d 390; World Pub. Co. v. United States, 10 Cir., 169 F. 2d 186; Hemphill Schools, Inc. v. Commissioner, 9 Cir., 137 F. 2d 961; Pelton Steel Casting Co. v. Commissioner, 7 Cir., 251 F. 2d 278."

With petitioner a rapid turnover of inventory and quick and almost certain[2] collection of accounts provided most of the operating funds.

We have not overlooked the petitioner's arguments of other reasonable needs of its business to justify the accumulation of such a large surplus. As to each, however, we are of the opinion that we cannot set aside the findings of the Tax Court as clearly erroneous.

The petitioner urges that the Tax Court may not have put the burden of proof on the Commissioner, in accordance with Section 534 of the 1954 Internal Revenue Code, to

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[2]Bad debt losses during the three tax years totaled only $2,553.92.

establish that the earnings and profits have been permitted to accumulate beyond the reasonable needs of the business. The Tax Court's opinion stated:

> "We have assumed, arguendo, throughout our discussion, that the burden of proof lay with the respondent. Our conclusions, however, are based upon and supported by the affirmative facts in the record, so that the burden of proof on the issue is not a significant factor."

Under the circumstances, the Tax Court's failure explicitly to impose the burden of proof on the Commissioner does not constitute reversible error. See *Smoot Sand & Gravel Corporation v. C.I.R., supra,* 274 F. 2d 495, 504.

The Tax Court found, in the language of the statute, that petitioner was availed of "for the purpose of preventing the imposition of the surtax upon its shareholders." There was no error in failing to go further and find that that was the primary or dominant purpose of the accumulation. See *Young Motor Co. v. Commissioner,* 1960, 1st Cir., 281 F. 2d 488, 491. Compare *Kerr-Cochran, Inc. v. Commissioner,* 8 Cir., 1958, 253 F. 2d 121, 123. Judge Learned Hand has called attention that this statute "stands on the footing of the participant's state of mind," viz., "the *purpose* of preventing the imposition of the surtax upon its stockholders," and that it "may need the support of presumption, indeed be practically unenforceable without it. . . ." *United Business Corporation v. Commissioner,* 2d Cir., 1933, 62 F. 2d 754, 755. The utility of the badly needed presumption arising from the accumulation of earnings or profits beyond the reasonable needs of the business is well

nigh destroyed if that presumption in turn is saddled with requirement of proof of "the primary or dominant purpose" of the accumulation.

The full opinion of the Tax Court makes further discussion unnecessary and undesirable. The decision is

AFFIRMED.

APPENDIX B

JUDGMENT

Extract from the Minutes of August 24, 1961

BARROW MANUFACTURING COMPANY, INC.,

NO. 18652 versus

COMMISSIONER OF INTERNAL REVENUE.

This cause came on to be heard on the petition of Barrow Manufacturing Company, Inc., for review of a decision of the Tax Court of the United States, and was argued by counsel;

ON CONSIDERATION WHEREOF, it is now here ordered, adjudged and decreed by this Court that the decision of the Tax Court in this cause be, and the same is hereby, affirmed.

* * * * * * *
* * * * *
* * * * * * *

APPENDIX C

SUPREME COURT OF THE UNITED STATES

No. , October Term, 1961

BARROW MANUFACTURING COMPANY, INC.,

Petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI

UPON CONSIDERATION of the application of counsel for petitioner(s),

IT IS ORDERED that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including January 21, 1962.

(S) HUGO L. BLACK
Associate Justice of the Supreme Court of the United States.

Dated this 24th
day of November, 1961.

APPENDIX D

Internal Revenue Code of 1954:

Sec. 531. Imposition of Accumulated Earnings Tax.

In addition to other taxes imposed by this chapter, there is hereby imposed for each taxable year on the accumulated taxable income (as defined in section 535) of every corporation described in section 532, an accumulated earnings tax equal to the sum of—

(1) 27½ percent of the accumulated taxable income not in excess of $100,000, plus

(2) 38½ percent of the accumulated taxable income in excess of $100,000.

Sec. 532. Corporations Subject to Accumulated Earnings Tax.

(a) GENERAL RULE.—The accumulated earnings tax imposed by section 531 shall apply to every corporation (other than those described in subsection (b)) formed or availed of for the purpose of avoiding the income tax with respect to its shareholders or the shareholders of any other corporation, by permitting earnings and profits to accumulate instead of being divided or distributed.

(b) EXCEPTIONS.—The accumulated earnings tax imposed by section 531 shall not apply to—

(1) a personal holding company (as defined in section 542),

(2) a foreign personal holding company (as defined in section 552), or

(3) a corporation exempt from tax under subchapter F (Section 501 and following).

Sec. 533. Evidence of Purpose to Avoid Income Tax.

(a) UNREASONABLE ACCUMULATION DETERMINATIVE OF PURPOSE.—For purposes of section 532, the fact that the earnings and profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the income tax with respect to shareholders, unless the corporation by the preponderance of the evidence shall prove to the contrary.

Sec. 534. Burden of Proof.

(a) GENERAL RULE.—In proceeding before the Tax Court involving a notice of deficiency based in whole or in part on the allegation that all or any part of the earnings and profits have been permitted to accumulate beyond the reasonable needs of the business, the burden of proof with respect to such allegation shall—

(1) if notification has not been sent in accordance with subsection (b), be on the Secretary or his delegation, or

(2) if the taxpayer has submitted the statement described in subsection (c), be on the Secretary or his delegate with respect to the grounds set forth in such statement in accordance with the provisions of such subsection.

(b) NOTIFICATION BY SECRETARY.—Before mailing the notice of deficiency referred to in subsection (a), the Secretary or his delegate may send by certified mail or registered mail a notification informing the taxpayer that the proposed notice of deficiency includes an amount with respect to the accumulated earnings tax imposed by

section 531. In the case of a notice of deficiency to which subsection (e)(2) applies and which is mailed on or before the 30th day after the date of the enactment of this sentence, the notification referred to in the preceding sentence may be mailed at any time on or before such 30th day.

(c) STATEMENT BY TAXPAYER.—Within such time (but not less than 30 days) after the mailing of the notification described in subsection (b) as the Secretary or his delegate may prescribe by regulations, the taxpayer may submit a statement of the grounds (together with facts sufficient to show the basis thereof) on which the taxpayer relies to establish that all or any part of the earnings and profits have not been permitted to accumulate beyond the reasonable needs of the business.

(e) APPLICATION OF SECTION.—

(1) Notwithstanding any other provision of law, this section shall apply with respect to taxable years to which this subchapter applies and (except as provided in paragraph (2)) to taxable years to which the corresponding provisions of prior revenue laws apply.

(2) In the case of a notice of deficiency for a taxable year to which this subchapter does not apply, this section shall apply only in the case of proceedings tried on the merits after the date of the enactment of this paragraph.

Sec. 535. Accumulated Taxable Income.

(a) DEFINITION.—For purposes of this subtitle, the term "accumulated taxable income" means the taxable income, adjusted in the manner provided in subsection (b), minus the sum of the dividends paid deduction (as defined

in section 561) and the accumulated earnings credit (as defined in subsection (c)).

(c) ACCUMULATED EARNINGS CREDIT.—

(1) GENERAL RULE.—For purposes of subsection (a), in the case of a corporation other than a mere holding or investment company, the accumulated earnings credit is (A) an amount equal to such part of the earnings and profits for the taxable year as are retained for the reasonable needs of the business, minus (B) the deduction allowed by subsection (b) (6). For purposes of this paragraph, the amount of the earnings and profits for the taxable year which are retained is the amount by which the earnings and profits for the taxable year exceed the dividends paid deduction (as defined in section 561) for such year.

(2) MINIMUM CREDIT.—The credit allowable under paragraph (1) shall in no case be less than the amount by which $100,000 exceeds the accumulated earnings and profits of the corporation at the close of the preceding taxable year.

Section. 537. Reasonable Needs of the Business.

For purposes of this part, the term "reasonable needs of the business" includes the reasonably anticipated needs of the business.